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WG I D-25.1/2

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EDAC Working Group I, International Export Control Systems

The Role of Government Credit in East-West Trade

I. Introduction.

1. This report attempts to analyze, insofar as currently available data permit, government credit operations in East-West trade and the effect of credits and credit guarantees on this trade. Broader aspects of financial relations between the Bloc and the West, such as the status of pre-war loans, compensation for nationalized properties, etc., are not considered here, although it is recognized that obligations under these debts affect the foreign exchange resources of the Bloc countries and are therefore related to the Bloc's ability to import.

2. This report is a part of the EDAC Work Program for the CFEP. It summarizes information previously assembled on the question of credit and its relation to East-West trade (as requested by the Executive Committee, ED/EC M-173, 8/9/55.1/)

II. Types of Government Credit Facilities for Export Financing.

1. Credit facilities are generally available to finance exports to the Soviet Bloc on the same terms as to other countries. Governmental credit facilities extended by most Western European and North American countries to promote their export trade include principally the following types:

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The following are the principal references:

- (a) EDAC D-96, 9/29/54; reprint of ECE Secretariat paper on "The Payments Problem in East-West Trade";
- (b) ED/EC D-80/18, 11/9/54 and D-80/51, 11/10/54, on "Western European Clearing ('Swing') Credits to the Soviet Bloc";
- (c) JOC Doc. 99, 3/16/55, Annexes VII-IX & Supplement 1 of 6/22/55; EDAC D-103/19, 7/15/55 and D-103/19a, 8/11/55 (IR 6946, 6/3/55) — all on Government Export Credit Guarantee;
- (d) CFEP Staff Study No. 10, 7/5/55, Part III, "Credit Extension to Soviet Bloc";
- (e) Working Group I/M-37, 4/6/55, M-40, 8/24/55, M-42, 10/12/55 and M-43, 11/1/55.

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(a) Government Credit Guarantees: Private exporters may obtain insurance, for stipulated fees, from government institutions, against some or all commercial, financial, and political risks, covering up to 100%, in some cases, of the value of the exports, on credit extended by them to foreign importers. Generally, credit guarantees are available only for credits of 5 years or less. They are usually available without distinction as to country or destination. However, as a matter of policy, the U.S. does not extend the ExIm Bank credit insurance to exports to the Bloc. Some other countries find it unnecessary (because of the clearing arrangements provided for in bilateral trade agreements) to make use of such facilities in their trade with the Bloc, or are reluctant to do so for reasons of financial policy. Credit guarantees may be particularly important for those countries which do not have bilateral trade agreements with "swing" credit arrangements with the Bloc.

(b) Government "Swing" Credits: "Swing" credits are a basic element of the bilateral trade and payments agreements under which most trade between the Bloc and the West is carried out.^{2/} These bilateral agreements usually provide that trade is to be balanced annually by shipments of commodities. However, one party may, during the course of the agreement, import more than it exports to the other, up to a stipulated amount known as the "swing". By the end of the period covered by the payments agreement the "debtor" country is supposed to export to the creditor to the extent necessary to balance the accounts or make settlement in cash. In practice, the Bloc countries as a whole have habitually imported more than they have exported. Western countries have in some cases suspended exports when the "swing" is exhausted, but others have continued to export even though the "swing" debits of the Bloc importing country exceeded the maximum provided in the payments agreement.^{3/} This practice has resulted in the extension of considerable credit to the Bloc even though Western countries have generally been reluctant to permit "swing" balances to become excessive.

(c) Medium Term Government Loans: In addition to the "swing" credit arrangements in trade agreements, special credits are sometimes granted Bloc countries by Western governments to finance specific exports from the West. In some cases these credits are a part of the trade agreement (but additional to the allowable "swing"). Normally, however, they are separate from the trade agreement and cover transactions not envisaged in the agreement. For countries which do not have "swing" credit arrangements with the Bloc, this type of credit (as well as government credit guarantees of private credits) may be an important method of promoting exports to the Bloc. These credits usually run for from 1 to 2 years on agricultural products to 3 to 10 years on capital goods. Unlike the "swing" credits, they bear interest and are payable in specified currencies or gold.

^{2/} The U.S., U.K., and Canada are the principal countries which do not conduct their trade with the Bloc under bilateral agreements.

^{3/} However, the private Western exporter is paid in full by his own government when shipment is made; hence, under the bilateral trade agreements, the exporter has no need for credit insurance, except for transactions outside the trade agreement.

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(d) Long-Term Government Loans: Another type of export credit, usually related to major capital goods projects and public works, is the government-to-government long-term loan. The amounts involved are generally much higher than in the short and medium-term types of credits, and payments are made over a period of 10 to 20 years or longer. However, as the U.S. is the principal capital-exporting nation in the world, long-term loans have not been an important factor in East-West trade. To the limited extent that they may export capital, Western countries normally prefer to develop markets in the free world, where economic ties are less likely to be abruptly severed for purely political reasons. However, the possibility of some relatively small long-term loans from the West to the Bloc to finance capital equipment or to renew close prewar financial ties (e.g., France and Poland) should not be ruled out.

III. Credit Operations in East-West Trade.

1. Strategic vs. Non-Strategic Trade. There is no evidence that government credit facilities have been granted to finance IL I goods. On the other hand, with respect to IL II items within quota limits, and IL III items, credit arrangements have generally been available on the same conditions as for non-strategic trade with the Bloc and trade with other free world countries. In other words, credit has not been extended to transactions in violation of COCOM control agreements, and, on the other hand, the withholding of credit has not been used as an additional control weapon, above and beyond the COCOM controls (except by the U.S.). Nevertheless, credit has not made any significant contribution to the Bloc's ability to acquire strategic goods. It is recognized that credits extended to the Bloc have the effect of facilitating Bloc imports. However, the Bloc's financial resources do not appear to be a limiting factor in procurement of strategic imports (i.e. imports of "rated area" items). We must look to the international control system, rather than the availability of or lack of credit, as the controlling factor in the Bloc's ability to acquire strategic goods.

2. Post-War Government Credit Operations in East-West Trade.

(a) Government Credit Guarantees: The role of government credit guarantees in East-West trade is limited, since such guarantees are normally not applicable to trade conducted under most bilateral agreements. However, government guarantees have been granted to insure private credits for transactions outside trade agreements or where trade agreements do not exist. The total volume of such guarantees appears to have been small in relation to total exports to the Bloc. Incomplete data show the following government guarantees of private credits to the Bloc:

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	<u>Amount Guaranteed during year shown</u>
(a) U.K., 1953 (19.2% of exports to Bloc in 1953)	\$ 17,800,000 ^{4/}
(b) Netherlands, 1953 (20.0% of exports to Bloc in 1953)	12,200,000
(c) Switzerland, 1953: 10% of total exports (data on guarantees on exports to Bloc separately are not available)	
(d) Sweden, 1954, principally to Poland for capital goods (4% of exports to the Bloc in 1954)	2,700,000 ^{5/}
(e) Belgium, 1954, to Poland (12% of 1954 exports to Bloc)	8,000,000
(f) Canada, 1955, wheat to Poland	16,000,000
(g) Germany, 1955, capital goods to Poland	8,000,000
(h) France, past and current	0
(i) Italy, past and current	0
	(\$64,700,000)

From the above incomplete information it may be estimated that roughly 3% of total free world exports to the Bloc ^{6/} are financed with the aid of government credit guarantees. It may be of some concern that total credit guarantee potentials of certain countries are substantial. However, these maximum government authorizations represent total potential guarantees on exports to all countries of the world. It is improbable that all or even a major part of the potential would be utilized for any one area. Sound banking practice as well as government policy makes such a possibility unlikely, particularly insofar as credit extension to the Bloc might be involved.

In a period of increasing competition for foreign markets, guarantees on exports to the Bloc may rise substantially over current levels. However, it would not seem reasonable to fear that they would become substantial in the context of the "potential" levels.

(b) Government "Swing" Credits: This type of credit appears to be relatively more significant than any other type of East-West trade financing. Total "swing" credits available to the Bloc in 1954 have been estimated at \$125 million, of which Finland provided \$32.2 million, Germany approximately \$30 million and Argentina \$25.0 million. Actual swing credits outstanding as of June 30, 1954, amounted to approximately \$140 million. In some cases, notably Argentina and Italy, the credits outstanding were substantially higher than the "allowable" swing ceilings; in others they were lower. While the "swing" concept provides that either party may obtain credit from the other, in practice swing credits have almost always been extended by the West to the Bloc, rarely by the Bloc to the West. Western practice in recent years has led to a more or less permanent "swing" credit to the Bloc of considerable magnitude.

^{4/} Of which 63% for Poland

^{5/} Total Swedish credit guarantees outstanding to the Bloc as of June 30, 1954, amounted to \$12,000,000.

^{6/} Free world exports to the Bloc amounted to \$1.7 billion in 1954.

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(c) Medium-Term Government Loans: During the immediate post-war period special credits were extended to Poland by several countries to finance machinery exports, the credits to be repaid by Poland by shipments of coal over a period of years.

More recent examples of such credits are: (a) A 1955 French credit of \$14,000,000 (supplementing the trade agreements swing of \$5,000,000) to Poland to finance electrical generating equipment (part of which is rated II II). This loan will be for 8 years, repayable in French francs. (b) A one-year loan made ^{in 1953} ~~this year~~ by France to Poland and Hungary to finance 500,000 tons (approximately \$30,000,000) of wheat and flour exports. The Polish and Hungarian governments are to make payments to the French Government in pounds sterling twelve months after deliveries. This credit was negotiated outside the framework of the French trade agreements.

Although special medium-term government loans have not, up to now, been of significant volume, they may take an upward trend as East-West trade becomes more competitive and less restricted.

(d) Long-Term Government Loans: For reasons already noted, long-term loans have been of little significance in East-West trade. The only known long-term loan was a \$110 million 20-year loan made by Sweden to the USSR in the immediate post-war period (1946) when relations with the Soviets were relatively friendly. Few countries have either the inclination or the capacity to export capital to the Bloc on a large scale. This condition is not likely to change materially even if East-West relations improve because the financial resources of most Western countries are limited and large-scale investment prospects in the West are more inviting than in the Bloc. However, if and when there appears to be a real and lasting improvement in East-West relations, long-term government loans from the West to the East may be resumed on a moderate scale. (It should be noted that the Bloc has also given indications of its possible intentions to finance large-scale development projects in certain underdeveloped areas of the free world.)

(e) Summary and Conclusions: An attempt has been made to estimate the annual credits to the Bloc and the totals outstanding at present and projected over the next two years. It should be emphasized that these estimates are based on fragmentary data. No claim is made that they are accurate, but they may be of some use in trying to assess the significance of credit in East-West trade:

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Estimated Trade Credits to the Soviet Bloc
(millions of U.S. dollars)

	<u>Total Credits Outstanding</u> (end of year)			
	<u>1954</u>	<u>1955</u>	<u>1956</u>	<u>1957</u>
Private Credits				
(a) As measured by government credit guarantees	50	75	85	95
Government to Government Credits				
(b) Swing credits in trade agreements	140	140	160	180
(c) Medium term loans	25	30	40	50
(d) Long term loans	<u>110</u>	<u>110</u>	<u>100</u>	<u>90</u>
Total	325	355	385	415

Net New Credits Made Available and Utilized During Year^{2/}

	<u>1955</u>	<u>1956</u>	<u>1957</u>
Private Credits			
(a) As measured by government credit guarantees	25	10	10
Government to Government Credits			
(b) Swing credits in trade agreements	0	20	20
(c) Medium term loans	5	10	10
(d) Long term loans	<u>0</u>	<u>-10</u>	<u>-10</u>
Total	30	30	30

As estimated in the above table, in the post-war period prior to the end of 1954, the Soviet Bloc had received imports to the extent of \$325 million for which it had not had to furnish exports, services, or gold. Credit had facilitated trade with the Bloc to that extent.

^{2/} Represents the net difference between credits extended to the Bloc and payments received from the Bloc. Total credits extended to the Bloc annually are estimated at \$200 million, as follows: Credit guarantees, \$50 million; "swing" credits, \$125 million; and medium term loans, \$25 million. Bloc repayments on credits previously granted are estimated at \$170 million annually, leaving a net of \$30 million of new additional credit each year.

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On the basis of experience in recent years the prospect is that small amounts of additional credit may become available. Net new credit in the amounts estimated (\$30 million annually) would have very little impact on the Bloc economy, representing as it does only about two percent of total imports from the free world (estimated to have been \$1,720,000,000 in 1954).^{8/} Withdrawal of existing credit facilities from the Bloc would require gradual liquidation or default on the obligations. The estimated total of \$355 million at the end of 1955 represents about 20 percent of one year's Bloc imports from the free world. Liquidation of this obligation might have some short-term impact on the Bloc economy.

With respect to strategic trade, there is no evidence to indicate that the extension of credit has been responsible for any violations of COCOM control levels. Permissible exports of some II II and II III items have been financed with government credit assistance, but this does not mean that exports of strategic goods have been increased because of the extension of credit. Such goods, being strategic, would undoubtedly have been purchased by the Bloc in the same quantities even if no credit had been available. The Bloc would probably not be prevented, by a denial of credit, from acquiring all the strategic goods it could get.^{2/}

In East-West trade as a whole credit has been a significant but not a major factor. Extension of credit to the Bloc appears to be increasing. While credit has undoubtedly promoted some non-strategic Western exports to the Bloc, it does not appear, up to the present at least, to have created any permanent patterns of trade which would significantly affect Western "reliance" on trade with the Bloc.^{10/}

Until recently, the Bloc has not extended any credit to the West, but there are indications that the Bloc may in the future make medium-term trade loans and long-term development loans to underdeveloped areas of the free world.

^{8/} In 1954 the trade deficit of the U.S. with the Bloc of \$43 million furnished the Bloc greater financial resources than the total estimated net new credits made available by the free world.

^{2/} Inasmuch as Bloc exports amount to \$1,700 million, the Bloc's foreign exchange resources are more than ample to finance the current level (or a much higher level) of Bloc strategic imports (\$168 million from COCOM countries in 1954). Any adjustments which might be required by a cessation of credit would presumably be made in the area of non-strategic trade (which comprises 90% of the total).

^{10/} This aspect of the problem should probably be given more careful consideration in the future.

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Credit is an aspect of East-West trade which, perhaps mistakenly, has never been the subject of international negotiation or control. However, the present time would seem inopportune to make any proposal to extend COCOM controls to cover credit operations. Nevertheless certain steps can be taken now to assign continuing responsibility within the EDAC structure to compile data on the financial aspects of East-West relations, analyze their impact on East-West trade in general, strategic trade in particular, Bloc financial resources, Soviet trade trends and tactics, and submit periodic reports.^{11/} Adequate factual information (which is now lacking) and analyses of East-West financial relations would be of considerable value not only to the economic defense program but also to U.S. foreign aid policies and programs in general.

^{11/} With respect to trade relations, and strategic trade in particular, it has been suggested that the following topics, among others, be made the subject of further inquiry: Relation of Credit to "Reliance" on Trade with the Bloc; Policies & Practices of Governments regarding Credit Guarantees; The Role of Private Financial Institutions in East-West Trade; Possible Role of Credit in the Expansion of Trade with China; Financial Relations of Japan with the Bloc; Soviet Policy & Practice with respect to Trade & Development Loans to Free World Countries; Periodic Statistical Reports on Credits & Loans from the West to the Bloc, by Countries and Categories.

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